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No. 87-1101

In The

Supreme Court of the United States

October Term, 1987

GTE SPRINT COMMUNICATIONS CORPORATION,

Appellant,

v.

ROGER D. SWEET, Director of the Illinois Department of Revenue, and JEROME COSENTINO, Treasurer of the State of Illinois,

Appellees.

On Appeal from the Supreme Court of Illinois

APPELLANT'S REPLY BRIEF

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I. The Act Does Not Tax Local Activity

The State vigorously argues that the taxable event under the Tax Act is purely local in nature. But the Illinois Supreme Court has already held that the taxable activity is not local but interstate calling—and this Court should defer to that construction. Goldberg Jurisdictional Statement at 8a-9a (hereafter "Goldberg Statement").

Even without such deference, the tax should be construed as one on interstate calling. The Tax Act clearly states that a 'tax is imposed upon the act or privilege of originating or receiving interstate telecommunications,' which activity depends upon and is inextricably bound to interstate transmission. Thus, the Illinois tax on the privilege of engaging in the instate portion of interstate communication, like the taxes in *American Trucking* on the privilege of using instate roads necessary for interstate travel, is a tax on interstate activity and must pass the Commerce Clause tests. *American Trucking Associations, Inc. v. Scheiner*, 107 S. Ct. 2829 (1987); GTE Sprint Jurisdictional Statement at 8-10 (hereafter "GTE Sprint Statement").

The State's contortion of the language and practical meaning of the Tax Act does not change this result. For example, although the State argues that the origination and receipt of a long distance call is "local" activity, this Court in *Michigan-Wisconsin Pipe Line Co. v. Calvert*, 347 U.S. 157 (1954) stated that a tax laid on the supposedly "local" loading and unloading of gas onto and off an interstate pipeline constituted a tax on interstate activity. The Court struck down the tax on the full value of the gas transmission because the "local" origination/termination was, as here, an inherent part of interstate transmission. The State also argues that, because the tax is applied to long distance calls which are charged to an Illinois service address (though they may be billed/paid for elsewhere), the tax is effectively a tax on local "sales" activity. But, in *Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653 (1948), previously discussed, a tax applied to ticket sales for interstate bus trips (which began and ended in the taxing state) was construed as taxing interstate

activity, although the taxed services were all purchased within the taxing state. GTE Sprint Statement at 9, n.5.[1] In sum, all applicable precedent supports the Illinois Supreme Court's construction of the statute. The State's arguments should therefore be rejected.[2]

II. The Tax Is in No Way Apportioned to the Illinois Portion of the Taxed Interstate Calling Activity

A tax on interstate activity must be apportioned, but, as already shown, the Illinois tax is not. In response, the State makes two arguments. First, the State argues that the tax needs no apportionment (is "100%" apportioned) because the tax taxes purely instate activity. This position must be rejected, for the reasons already stated *supra* at 1-2.

Further, the legal precedents the State cites to pursue its argument that the tax is local are clearly inapplicable. For example, the State cites to *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) where the Court held an "unapportioned" tax valid. However, the tax there was placed on the distinctly local severance of coal from the land, even though what was mined instate was *later* destined for interstate transportation and out-of-state sale, both divorced from the mining activity itself. State's Motion at 9. Here, participation in the origination/receipt of interstate calls cannot be divorced from interstate transmission, as shown *supra*. The Illinois tax in no way resembles a severance tax.

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[1] GTE Sprint has already demonstrated that the tax does not tax calls "purchased at retail" in Illinois, because the tax is assessed against calls even when billed or paid for *outside* Illinois. GTE Sprint Statement at 10.

[2] The State also argues that the Act taxes one person for the entire charge of a call because the telephone company may elect to "divide the charges for telephone services between the originator and recipient" and that, therefore, the tax is somehow a "local tax." State's Motion at 6. There is absolutely nothing in the tax or the record which demonstrates that the phone companies have the discretion, right or practice of so dividing the charges for interstate calls. Such a division would be legally irrelevant, anyhow. *See* discussion *infra* at 6.

The State also cites use and sales tax cases to argue the tax is local and needs no apportionment. But the Tax Act does not resemble such taxes. As to use taxes, the Act does not seek to tax a separable use or consumption instate of a physical item separately and formerly acquired out-of-state. As to a "sales" tax, GTE Sprint has already demonstrated that the Tax Act is applied to calls charged to an Illinois phone, but regardless of whether they are billed or paid for outside the state. Thus, the tax does not even reflect a typical sale made at one instate locale. The "charge" locale of the tax is merely incidental, in any event, and cannot obscure the fact that participation in interstate transmission is not a "local" event, as both courts below recognized. Goldberg Statement at 9a, 21a-22a.[3]

The State also argues, however, that, even assuming the taxable event *is* interstate calling activity, the tax contains sufficient apportionment because it limits itself to long distance calls "sold" in Illinois. State's Motion at 16. Even assuming the tax is limited to calls "sold" in Illinois (which it is not), the tax is still not apportioned. The external consistency test requires that an apportionment formula divide taxable, instate activity from non-taxable, out-of-state activity, along the lines of how the tax base is economically generated. *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983). However, the limitation of the tax to calls charged to an Illinois address does not do so.

To illustrate: In *Central Greyhound*, discussed above, New York assessed a sales tax on bus trips beginning and ending in New York, but travelling through New Jersey and Pennsylvania

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[3] GTE Sprint has already shown that the tax does not resemble a "complementary" use tax. GTE Sprint Statement at 23-24. Further, this Court has reserved ruling on the question of whether, on out-of-state purchases by a resident, the resident can be taxed by both the outside state on the sale and by the resident state on the use. *Williams v. Vermont*, 472 U.S. 14 (1985). There is thus typically no question of the proper apportionment of use/sales taxes as the Court has yet to reach that issue. There certainly was no such question posed in the *National Geographic* case cited by the State. State's Motion at 9.

as well. The tax was laid on the full purchase price of the trip tickets. The Court struck down the tax despite the fact that *all* ticket sales were made in New York. GTE Sprint Statement at 12, n.6. Clearly, confining the tax to tickets purchased in New York did not limit the tax to that portion of the interstate travel (or costs) attributable to New York. Likewise, the supposed Illinois "charge" apportionment formula in no way adjusts the tax for the differences in the amount of Illinois activity occurring among different interstate phone calls; the tax is be applied to all calls equally.[4] Thus, the "limit" in the Illinois tax is arbitrary and does not apportion it, under *Container*.[5]

III. The Tax Act Discriminates against Interstate Commerce

A. The Facial Equality of the Tax Does Not Negate Its Discriminatory Effect

It does not follow, as the State maintains, that simply because the Tax Act applies a 5% tax to both intra- and interstate calls, the tax does not discriminate. Just last term, this Court struck down such a facially "equal" tax, stating:

> [T]he Commerce Clause has a deeper meaning that may be implicated even though state provisions . . . do not allocate tax burdens between insiders and outsiders in a manner that is facially discriminatory.

American Trucking, 107 S. Ct. at 2839. In *American Trucking*, an equal and flat tax was applied to trucks in both intra- and interstate commerce, for the privilege of utilizing Pennsylvania's

[4] The State cites *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978) to argue that the charge limit in the Illinois tax effects apportionment. In *Moorman*, the single factor sales formula was utilized to divide instate *income* from out-of-state *income*. But *Moorman* in no way supports the use of a single factor sales formula to apportion a tax, not on income, but on interstate calling activity.

[5] The State suggests no better apportionment is possible. State's Motion at 17, n.7. Florida's tax on long distance phone calls beginning or ending in Florida, based on instate transmission mileage, belies the State's argument. GTE Sprint Statement at 13, n.7.

highways. Despite this "equality" of taxing, the Court held that the interstate carriers were bearing a proportionately heavier tax burden than the instate carriers, because the interstate carriers would tend to utilize instate facilities less than the instate carriers:

> Although out-of-state carriers obtain a privilege to use Pennsylvania's highways that is nominally equivalent to that which local carriers receive, imposition of the flat taxes for a privilege that is several times more valuable to a local business than to its out-of-state competitors is unquestionably discriminatory and thus offends the Commerce Clause.

American Trucking, 107 S. Ct. at 2841. Similarly, the "equal" Illinois tax is proportionately higher on interstate calls than on intrastate calls, because interstate calls utilize the instate facilities far less than instate calls do.[6] Thus, the 5%/5% treatment cannot save the Illinois tax.[7]

B. The Tax Fails the Internal Consistency Test

The State argues the tax meets the internal consistency test because "[i]f each, or any, of the other states enacted the tax in question—a tax on a person originating or receiving a call in that state and charging the call to a service address in that state—there would be no discriminatory impact upon interstate commerce." State's Motion at 12. This argument misses the mark.

Specifically, the State's argument assumes that, under the internal consistency test, the Court need only hypothesize that

[6] The Illinois tax is even more insidious than those struck down in *American Trucking* because the *less* Illinois activity is involved in an interstate call, the *more* Illinois taxes it. GTE Sprint Statement at 26. Further, this tendency of the tax to so discriminate is enough to invalidate it. *American Trucking*, 107 S. Ct. at 2842.

[7] The State invokes the *Commonwealth Edison* tax on the severance of coal in Montana to argue the Illinois tax is nondiscriminatory. But, there, the tax was upheld because it was laid on purely local activity, so facial equality between intra- and interstate taxes was not even an issue.

a tax *identical* to the tax at issue is applied in every state, and end its inquiry there. However, in *Armco v. Hardesty*, 467 U.S. 638, 644 (1984), this Court held that the internal consistency test required the application of the same "or *like*" tax in every jurisdiction. This *must* be the test for the following reason: As long as a state tax passes constitutional muster, it must be upheld. As a consequence, if a tax on long distance calls originating/terminating and charged to an Illinois address is deemed constitutional, other states should be permitted to pass taxes on long distance calls which (for example) originate/terminate and are billed or paid for within their borders, because, constitutionally, such taxes are virtually identical to the Illinois tax. But the imposition of both such taxes leads to multiple states taxing, realistically, the same purchase price for the same call. Therefore, the *Armco* internal consistency test must include application of "like" taxes to foreclose semantical end-runs around the internal consistency test. As a consequence, the tax fails this test. GTE Sprint Statement at 15-17.

C. Other States Could Tax the Same or Different Entities on the Same Calls

The State argues that "no other jurisdiction has an adequate basis to tax *the person* who is in Illinois during the telephone call and charges the telephone call to an Illinois address," so the Illinois tax poses no real threat of multiple taxation. State's Motion at 12. This is wrong. Sprint has already submitted uncontested evidence to show that a business may charge a long distance call to a phone in Illinois, but be billed for the call in another office in another state—and that Sprint could assess two different states' taxes on the call on the same bill. GTE Sprint Statement at 16 and n.9. Further, the relevancy of the State's point is questionable, in any event, since this Court long ago held that the pertinent inquiry is whether or not the same *activity* is subject to multiple taxation, regardless of whether one or more persons or entities bear it. *Telegraph Co. v. Texas*, 105 U.S. 460, 465 (1881).[8] Thus, the State's argument collapses upon factual and legal scrutiny.

D. The Credit Provision Does Not Cure the Discriminatory Effect of the Tax

The State finally argues that, in the event Illinois and another state tax the same call, the Tax Act provides a credit in the amount of the other state's tax, so that any threat of multiple taxation is foreclosed. It is not.

First, as previously shown, if the tax applied by the other state does not equal or exceed the Illinois tax, Illinois continues to tax the call along with the other state, but to a lesser degree. GTE Sprint Statement at 22. Under the credit provision, a taxpayer paying a 3% Indiana tax and a 5% Illinois tax on the same call would be required to pay the tax in Indiana, pay the tax in Illinois, receive a credit in Illinois of 3%—all so that its Illinois tax would simply be reduced. The taxpayer would still have paid two taxes on the same call, albeit at a lower rate in Illinois. Further, payment of both taxes constitutes impermissible multiple taxation because the credit reduction in no way operates to divide the tax between Indiana and Illinois, according to what percentage of the calling activity occurred in each state. *See* discussion *supra* at 4-5; GTE Sprint Statement at 22. In addition, even though the credit provision would eradicate the Illinois tax if a tax applied by another state equalled or exceeded the Illinois tax, there is certainly no guarantee this will occur. Therefore, the tax remains discriminatory, despite the credit provision. *Cf. Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 76 (1963) (Brennan, J., concurring).

Second, the significant effort required of the interstate callers to obtain the tax credit creates a burden on such callers not borne by instate callers, and effects discrimination. GTE Sprint Statement at 22. The State maintains this does not

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[8] The State's citation to *Tyler Pipe* on this point is irrelevant because the Tax Act is not an instate "sales" tax, as is the tax in the example discussed in the *Tyler Pipe* quote.

impose an undue burden, because the Illinois credit provision is identical to use tax credits (for paid sales taxes), "which [credit provisions] have been upheld by this Court." State's Motion at 13. However, this Court has never "upheld" any such credit provisions under Commerce Clause attack. Indeed, this Court has twice reserved for decision the very question of whether use and sales taxes even tax the same activity and, therefore, by implication, whether application of a use tax even requires a credit for a paid sales tax.[9] Even more important, GTE Sprint maintains that the Tax Act simply cannot constitute a "complementary" sales/use tax scheme, because the activity taxed is vastly different. *See* discussion *supra* at 3. Therefore, the existence of unreviewed credit provisions in use taxes is not probative of the legality of their operation with regard to interstate transmission taxes.[10] This Court should therefore find the credit provision inadequate or, at the least, accept review of this unresolved question.[11]

IV. The Illinois Tax Is in No Way Related to Illinois Benefits Accorded the Taxed Activity

GTE Sprint has already shown that the more out-of-state calling activity a long distance call involves, the heavier the

[9] *See* n. 3, *supra*. The states have generally provided use tax credits for paid sales taxes, for fear this Court will hold that the sale and use of a tangible good in two different states represents the same activity. But this Court has not directly ruled on the question. *See Williams v. Vermont, supra*; *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). The footnote in *Tyler Pipe* the State refers to merely suggests that credit provisions *might* alleviate discrimination which *might* arise under the sales/use tax schemes.

[10] Further, a credit provision in the typical use tax must operate much differently than the credit provision at issue here inasmuch as use taxes are applied to more casual activity than the constant and pervasive activity of interstate calling at issue here.

[11] The State maintains that the ability of the credit provision to save the Illinois tax cannot be reviewed because Sprint has not demonstrated *actual* application of other taxes to the same calling activity taxed by Illinois. State's Motion at 13, n.5. Such a showing is clearly not necessary under *Armco*. *See* GTE Sprint Statement at 15.

Illinois tax becomes. GTE Sprint Statement at 26. The tax is thus absolutely unrelated to the measure of services or benefits the State provides with regard to these calls, and flunks the fourth *Complete Auto* test.

The State's arguments in response are weak. The State, citing *Commonwealth Edison*, implies that the fair relation test is satisfied as long as the taxed activity has some nexus to the taxing state since the state may tax to any degree, on the basis of the 'organized society' benefits it provides to all activities within its border. Just last term, however, this Court rejected the *Commonwealth Edison* emasculation of the fair relation test. In *American Trucking*, the Court held that a flat tax on interstate carriers for the privilege of using Pennsylvania's roads in their interstate travel was unconstitutional, under a much stricter fair relation test:

> [W]hen the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce.
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> * * *
>
> . . . But a tax levied for the privilege of using roads, and not their actual use, may, in the normal course of operations and not as a fanciful hypothesis, involve an undue burden on interstate carriers. While the privilege extended by a State is . . . theoretically the same for all vehicles, whether interstate or intrastate, the intrastate vehicle can and will exercise the privilege whenever it is in operation, while the interstate vehicle must necessarily forego the privilege some of the time simply because of its interstate character, *i.e.*, because it operates in other states as well. In the general average of instances, the privilege is not as valuable to the interstate as to the intrastate carrier.

American Trucking, 107 S. Ct. at 2844 (citations omitted). Likewise, here, the privilege Illinois accords interstate—versus intrastate—callers is worth significantly *less* because intrastate callers use Illinois facilities more than interstate callers do. Under *American Trucking*, the Illinois tax fails. *See* n.6 *supra*.

The State also argues that the tax is 'fairly related' because it does not impose a tax on a party outside Illinois. The State is simply wrong. Although a call may be charged to equipment in Illinois and involve a caller in Illinois, it is possible that the tax may be billed to or paid for by a party outside Illinois, as the multi-state business example demonstrates. *See* discussion *supra* at 6. Furthermore, simply imposing the tax on an Illinois resident does not fairly relate the Illinois tax to that portion of the interstate transmission activity which occurs in Illinois.

Finally, the State claims the tax is 'fairly related' because it is "based on the value the person in Illinois places upon [the taxed] activity measured by the amount he is *willing* to pay for a telephone call." State's Motion at 15-16 (emphasis added). This argument is nonsensical. Nothing in the record supports such a statement, and it defies common sense to state that the consumer decides how much he wishes to pay the carrier for the carrier's services. The State's fair relation argument is thus easily dismissed, and the tax deserves invalidation by this Court, pursuant to *American Trucking*.

V. Conclusion

For the reasons stated above, GTE Sprint respectfully requests that this Court note probable jurisdiction and reverse the decision of the Illinois Supreme Court.

Respectfully submitted,

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